THE RALSTAN GROUP

Incorporation on a property rental business

The Incorporation Route – 'Rolling Over' Gains

Under this route, you could transfer your property business into a newly formed company in exchange for the issue of shares in that company.

Ordinarily, such a transfer would be a disposal for capital gains tax purposes at market value. However, as the consideration is received wholly in exchange for shares, then providing that the statutory conditions for the relief are satisfied, the gain will be rolled over into the base cost of the shares. Mortgage interest relief is still available against rental profits in a company.

The advantage of the incorporation route is that the company will be treated as acquiring the assets at their **current market value**. The amount of chargeable gain is rolled over into the base cost of the shares received. Corporation Tax rates have been steadily reducing, currently 19%.

The following requirements satisfy the statutory conditions for incorporation relief:-

a) The business must be transferred with all of its assets (or all its assets other than cash).

b) The business must be transferred as a going concern.

c) The consideration for the transfer of the business will be wholly or partly shares issued by the transferee company to the transferor.

Case Study

<u>Background</u>

Colin and Diane jointly own several properties (value £3 million), which they let to third parties at commercial rents.

Colin and Diane busy themselves in the commercial aspects of the properties and negotiate their own reviews, new leases, repairs and up keep, and rental collection.

Colin and Diane plan to be more efficient with their property holdings.

Problem

There are significant capital gains in the property values. Mortgage interest relief will only be available on personally held property as a tax credit from April 2020.

Solution

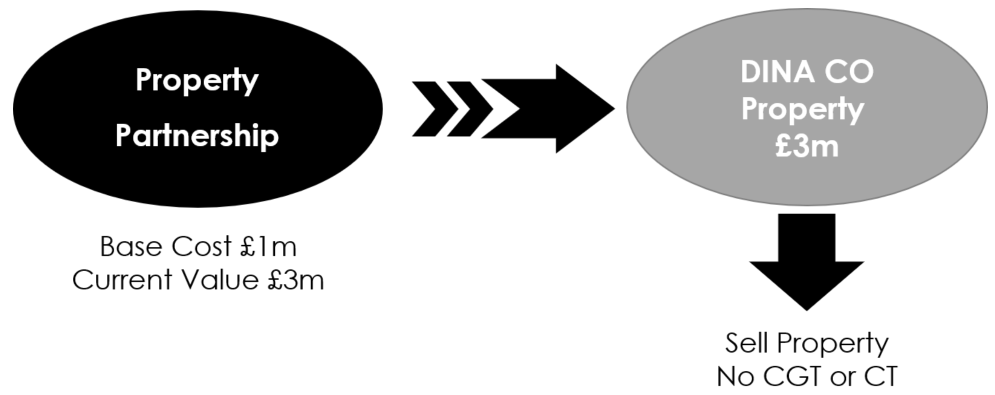
Colin and Diane incorporate the property assets into their UK Company Dina Co.

Colin and Diane transfer the business of property letting to Dina Co in return for shares or credit to Director's Loan Account (DLA).

Dina Co is deemed to acquire the business and assets of the partnership at their current market value of £3million.

The shares of Dina Co have a value for capital gains tax purposes of £3m less the gain rolled over of £1m.

Dina Co may then continue the letting business and decide to sell each property, potentially without incurring capital gains tax and corporation tax.



Considerations

1) There may be a Stamp Duty Land Tax charge on the market value for the property transferred. However, there is a relief from paying SDLT for partnerships.

2) It's important to consider the existing position with loans, as a lender would have to agree to the transfer, or the mortgages could be rescheduled before incorporation.

Pre-incorporation Planning

There is an additional planning tool available under the incorporation rule. The transfer of liabilities will not be treated as consideration by HMRC, by concession. Therefore, it is possible for you to remortgage your portfolio and raise additional funds before the incorporation.

Once the incorporation has been completed, you can introduce the cash monies from the remortgage as a director's loan to the company, thus enabling the company to repay its mortgage liabilities. The director's loan can then be withdrawn without the need to take dividends or salary.

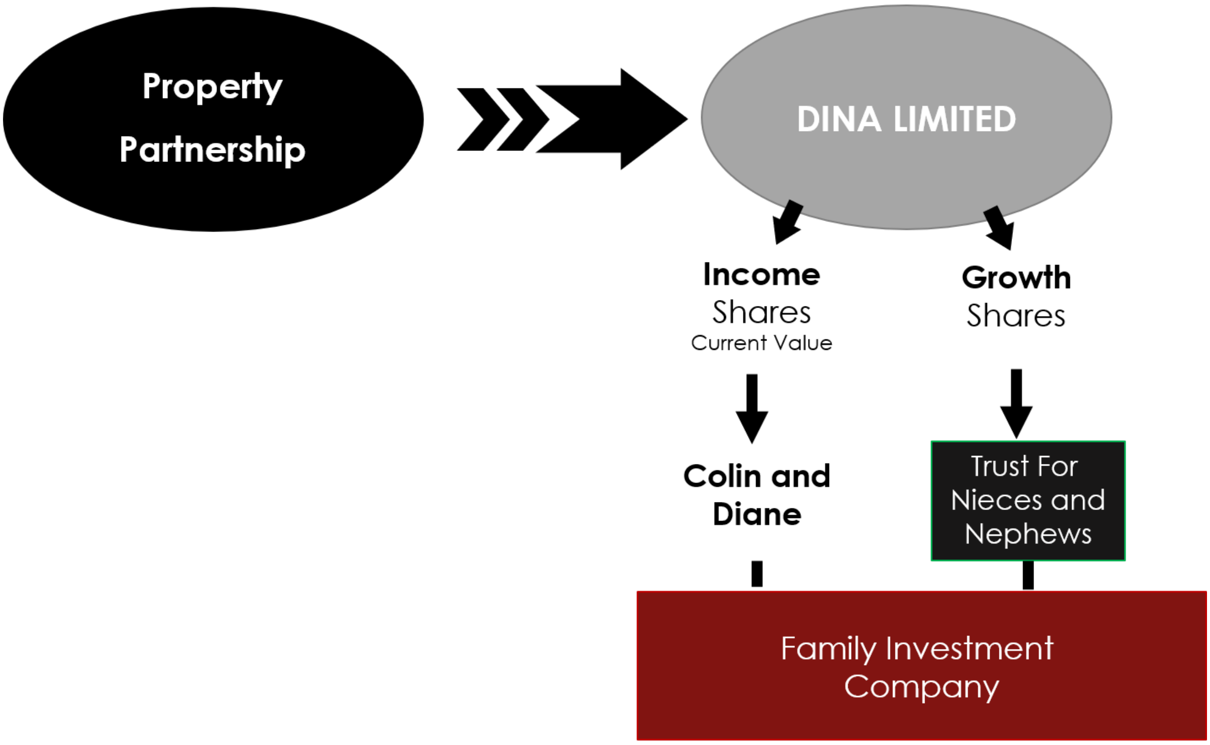
Alternatively, the capital raised could be deployed outside the company in a number of investment plans which provide estate planning opportunities. Trust vehicles can be used to generate income if required, whilst ensuring the capital value will pass to your family.

Freezer

Incorporation creates an opportunity to fix the value of shares to the current value of the property portfolio, by issuing an additional share class, i.e. 'deferred shares', which can capture all future growth in the company's assets.

Future income can be accessed by way of future dividends, or management charges.

The 'deferred shares' can be placed in a suitable trust for the benefit of your children, outside your estate, thereby 'freezing' the IHT liability.



Trust Planning

A trust can be established for the shares of the company.

Key features of the trust mean assets held by the trust do not form part of your estate for IHT purposes and access to the trust is possible in a number of ways.

In Summary

As the company will have acquired your assets at their current market value, any subsequent property sale reflecting the current market value may not be subject to tax in the company.

Utilising the director's loan idea could then allow you to withdraw funds from the company efficiently.

The 'freezer shares' could mean future property growth will not increase the IHT liability and the Trust can provide some estate planning and certainty in your lifetime.

Some clients use the incorporation process to streamline their property activities which can lead to investment opportunities for their Financial Adviser.

With CT rates at historically low levels, it is possible to use the company as a store for family wealth and an effective succession vehicle, without losing control.

The case study on incorporation is just one of several planning options that can be utilised for clients with illiquid assets like property. These options can sit alongside to compliment your other Financial Planning solutions.

IMPORTANT NOTES

Nothing in this article should be construed as advice. The contents of this article are intended to stimulate your and your client's interest in trusts and tax planning with a view to taking further professional advice upon your or your client's specific circumstances. No action should be taken without further professional advice from an appropriately qualified professional.